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RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE  
RUEHCG/AMCONSUL CHENNAI 2337  
RUEHKP/AMCONSUL KARACHI 8455  
RUEHCI/AMCONSUL KOLKATA 1650  
RUEHLH/AMCONSUL LAHORE 4283  
RUEHBI/AMCONSUL MUMBAI 1446  
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UNCLAS SECTION 01 OF 03 NEW DELHI 000291

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SCA/INS FOR JASHWORTH/TFITZGIBBONS  
EEB FOR NWEBER  
USDA PASS FAS/OCRA/HIGGISTON  
USTR FOR CLILIENTFELD/AADLER  
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA - MNUGENT  
USDOC FOR 4530/ITA/MAC/OSA/LDROKER/ASTERN

E.O. 12958: N/A  
TAGS: [BTIO](#) [EAGR](#) [ECON](#) [EINV](#) [IN](#) [ETRD](#) [EFIN](#) [PGOV](#)  
SUBJECT: ITC'S GRADUAL, BACK-END RETAIL MODEL WORKING

REF: A) NEW DELHI 000095 B) MUMBAI 000019

NEW DELHI 00000291 001.2 OF 003

¶1. (SBU) SUMMARY: Despite the recent backlash against organized retailers and subsequent re-evaluation of business models for some players in the industry (reftels), established players such as the conglomerate Indian Tobacco Company (ITC) are more optimistic about their prospects in the fresh produce business. ITC officials are working closely with farmers, building long-term relationships, and planning to expand operations to take advantage of the company's unique foothold in agriculture, which was originally established through its e-Choupal operations that directly serve farming communities. ITC's slow development of a fuller, albeit shorter, supply chain than most of its competitors appears to be serving it well, and the future of its retail outlets in markets like Hyderabad, outside the five major metros, seems bright.

¶2. (SBU) SUMMARY CONTINUED: This cable is part of a series that will address the potential impact of organized retail on the agricultural sector. Although the front end of the "retail revolution" has attracted considerable attention through new stores and shopping formats, these cables focus on the back end of the supply chain and examine a few of the business models being used by the private sector to engage India's farmers. END SUMMARY.

ITC FOCUSING ON LINKS TO THE FARMER  
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¶3. (SBU) On January 18, Congenoffs met with Mr. Praveen, ITC's sourcing executive for its horticultural retail business. (Note: ITC, a company that is over a century old, launched its agro-business arm in 1990, focusing primarily on agricultural exports. End note.) Praveen took Congenoffs to see ITC's complete supply chain for fresh produce in Hyderabad, which links farmers to consumers within a single day and is limited to a narrow geographic area. He explained that ITC first entered this market in August 2006, opening stores that - unlike its competitors - only sell fresh fruits and vegetables under the name Choupal Fresh, "choupal" being the Hindi word for "gathering place." (Note: Most of the other organized retailers include a variety of goods in their grocery

stores, including processed food items, staples such as lentils and rice, and even apparel, in an effort to become "one-stop shops" for consumers. End note.)

14. (SBU) The first stops on the tour were two farms in Vantimamidi, a town about 40 kilometers from Hyderabad. The first farm, which was five and a half acres, grows red and yellow capsicum peppers and celery for ITC. The second farm - which was about twelve acres - grows a variety of crops for ITC, including gourds, sweet corn, broccoli, lemons, and tomatoes. Praveen explained that because many of these crops are not native to India, an "extension team" - which consists of six local agricultural specialists and three ITC corporate employees - visits the farmer weekly to help properly plant and tend their crops. He emphasized that ITC provides the ideas for these types of crops to farmers based on the demand at its Choupal Fresh stores, and verbally guarantees farmers that the company will buy all such produce. As a result, the company takes a revenue hit if the new crops fail to sell well. Praveen highlighted the case of celery, which was not selling well at the stores because customers did not know how to cook or serve it. (Comment: This example contradicts his earlier statement that new crop ideas are demand-driven, indicating that the company probably experiments with a variety of crops for consumers. End comment.)

15. (SBU) Praveen then explained ITC's price discovery process for crops that it does not guarantee to buy, i.e. traditional crops such as tomatoes. The company's local representatives go to the mandis - government-regulated markets - in the early morning and report back the benchmark mandi price that day. ITC then offers that price to farmers with whom it has a relationship - usually via mobile phone calls - which saves the farmer the commission usually paid to the mandi-based trader and the transportation costs of bringing produce to the mandis.

16. (SBU) Instead, ITC's farmers bring the produce directly to an ITC collection center, which is generally closer to the farm, and

NEW DELHI 00000291 002.2 OF 003

receive cash on the spot. Praveen stated that ITC holds a state Agricultural Produce Marketing Committee (APMC) license to buy directly from farmers in Andhra Pradesh (AP). (Note: AP is one of several states that allows this type of business relationship between farmers and organized retailers, but there are still some states where retailers are obligated to source from mandis. End note.) Praveen stated that ITC has not faced any protests from middlemen, although he estimated that about 60 mandi traders had been put out of business by ITC's direct tie-ups with farmers in the Hyderabad area. He noted that the traders were looking to develop their own produce markets or alternate businesses.

17. (SBU) Praveen highlighted that ITC works with about 400 to 500 farmers in Hyderabad, the majority of which own between three and five acres of land. (Note: According to Indian government statistics, the average farm size in India is about two acres and these farmers would technically be in the slightly larger "small landowner" category. The second, 12-acre farm would technically fall under the "medium to large" category. End note.) Praveen related that ITC's Choupal Fresh stores procure about 75 percent of their goods from these farms. They still rely on the mandis for about a quarter of their produce, but are working to reduce this figure.

#### SHORT SUPPLY CHAIN, MINIMAL INFRASTRUCTURE

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18. (SBU) After visiting the farms, Congenoffs visited one of ITC's two collection centers in the Hyderabad area, which was a short distance from the farms on the local highway. The two centers together sent roughly 75 percent of the procured goods directly to Choupal Fresh outlets that day, with the remaining 25 percent sent to a central distribution center. The collection center was remarkably similar to the "Ranger Fresh" centers run by ITC competitor Reliance Retail (reftel A), which consist of two concrete rooms that hold fresh produce and have no cold storage capability. Praveen explained that farmers generally dropped off their produce at varying times during the day, and ITC would then ship the goods out shortly thereafter. Posters on the wall explained ITC's quality

standards for different produce items.

¶9. (SBU) The next stop was a visit to a distribution center called Agility, which is run by a separate logistics company and partially leased by ITC (as well as three or four of its competitors) for its warehousing and distribution needs. Praveen explained that because of its maximum one-day storage and short supply chain, ITC does not need refrigerated trucks. ITC's leased area included a cold storage unit, sorting and grading tables, and a ripening room. Praveen noted that ITC would consider building its own warehouse if demand for its produce grows significantly.

¶10. (SBU) The last stop in the chain was the original Choupal Fresh outlet, a small but clean store in Hyderabad that sells only fresh fruits and vegetables. Mr. Praveen noted that the company has six other Choupal Fresh stores in the Hyderabad area, and also operates in Pune, Maharashtra, and Chandigarh, Punjab. Praveen asserted that although Reliance can offer lower prices, it cannot offer the same quality that ITC's stores can, and quality is the ultimate determinant in the consumer's mind of where to shop.

#### ITC LEVERAGING REPUTATION, RELATIONSHIPS

¶11. (SBU) Finally, Congenoffs met with Srinivasa Rao, the head of new initiatives at ITC's International Business Division (IBD). Rao highlighted ITC's long-standing relationship with farmers and the agricultural community, which originated with its work in tobacco production decades ago. In 2000, ITC gained a foothold into agricultural retailing through its e-Choupal venture, in which the company set up computer kiosks in villages to allow farmers to check real-time market prices for commodities such as rice and soybeans. The farmers could then choose to sell their harvest to the mandis or directly to ITC, which offered competitive prices as well as extension services such as technical training. (Note: The e-Choupal program has been praised by development agencies as a model for providing innovations and opportunities to poor farmers. End note.) Rao emphasized that building these relationships with farmers gave

NEW DELHI 00000291 003.2 OF 003

ITC a direct link to the agricultural communities in which it operated; the company now runs 6,500 e-Choupal kiosks shared among 40,000 villages, and can reach over 4 million farmers in eight states (Madhya Pradesh, Maharashtra, Rajasthan, Haryana, Karnataka, Andhra Pradesh, Uttar Pradesh and Uttarakhand).

¶12. (SBU) Rao asserted that ITC entered the fresh produce segment to expand on its business initiatives and reach out to smaller farmers as a form of corporate social responsibility, but was upfront that the company was looking to cash in on the organized retail boom in India. He stated that ITC's goal for this business segment was to eliminate middlemen and provide a faster, cheaper farm-to-plate chain using a direct, deep, and year-round relationship with the farming community. Rao emphasized ITC's commitment to the farmers, noting that the company's agricultural scientists spent several months with them on soil and water testing to determine which crops could work and then providing the training and techniques required for production. He said that the business is new for ITC and still developing, but claimed that the farmers are already doubling their yields and incomes based on the extension services that the company provides. Rao said ITC hopes to eventually create a two-way flow between the company and farmers, exchanging produce and agricultural inputs at better-than-market rates. He believes that this can create a "virtuous cycle" for the agricultural community, in which both the company and farmer need each other to succeed.

¶13. (SBU) In terms of other models for organized retail, Rao believes they do not offer the farmer adequate choices and do not create "inclusive growth." Rao gave an example of failed contract farming in which only two percent of farmers honored a signed contract with a company because prices had increased at the mandis, and since contracts are essentially unenforceable, the company was left without adequate produce. With ITC's model, Rao explained, the farmer always has the choice to sell at the mandis but the company will virtually guarantee them a better price, because it will not charge the 10 percent commission fee demanded by traders. However,

Rao believes that contract farming can work with niche products such as baby corn, which is not regularly traded at the mandis and can provide a farmer who takes a risk in planting a more unusual crop with the security of a guaranteed buyer.

¶14. (SBU) Overall, Rao and Praveen were both optimistic about the company's prospects in the fresh produce business segment. Rao mentioned that the company plans to expand to 50 cities from three cities now within three or four years, and would like to establish about 10 Choupal Fresh stores in each metro area. Praveen explained that the company wants to extend its Hyderabad presence to 15 stores by March 2008, which may result in more collection centers and possibly ITC's development of its own cold storage capabilities and infrastructure. (Note: While moving slowly on retail stores, ITC has also been involved in wholesaling. Its Choupal Fresh stores sell wholesale to small retailers, while ITC also sells wholesale to other organized retailers and wholesale markets. End note.)

#### COMMENT

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¶15. (SBU) ITC's slow approach to organized retail - a focus on developing farmer relationships at the back-end of the supply chain, its gradual rollout of retail stores, and its cautious expansion to newer geographic areas - appears to give the company a lower profile and stronger standing in the areas where it operates. ITC's reputation and long-standing ties to farmers also seem to help the company establish a firm link in this new market. However, it is not clear if the company would be as successful in other parts of India - notably the north - where the issue is more contentious. ITC does not appear to be reaching the most vulnerable and poorest segments of the agricultural sector in their short and narrow business model. However, it is apparent that ITC wants to be a player in this business for the long term and, seemingly unlike its competitors, plans to pay adequate attention to the farmer to achieve that goal.

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